

## ARTICLES

### **“Owner Finance! No Banks Needed!” Consumer Protection Analysis of Seller-Financed Home Sales: a Texas Case Study**

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#### I. INTRODUCTION

Somewhere along the continuum of property rights between owners and renters lies a peculiar property interest called a “contract for deed.” Contracts for deed are executory contracts in which buyers purchase their homes with installment payments while the seller holds the deed as security for payment.<sup>1</sup> In many states, especially where land is cheap and plentiful, seller financing through contract for deed fills a necessary gap in the increasingly tight credit market. A family with \$4000 in cash and no credit history will not qualify for a traditional mortgage, but may be able to find a home for \$19,000 that the seller agrees to finance at 9% interest.<sup>2</sup> A deal is struck, a contract is signed, and a family has a stable home for their children.

Or that is how it should work. Complicating this rosy free-market picture of eager buyers and willing sellers is a long history of predatory selling practices and abuse in the contract for deed system. There are many examples of families who pay under a contract for deed for years, only to find out that the home has existing liens or that the seller plans to evict them and start over with new buyers. To address these abuses, states have taken different approaches to balance the power of buyers and sellers. Some states treat contracts for deed as mortgages, with the same rights as an owner with a bank loan.<sup>3</sup> Others take a hybrid

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1. See 11 TEX. PRAC., TEXAS METHODS OF PRACTICE § 3A:1 (3d ed. 2012); *Ward v. Malone*, 115 S.W.3d 267, 271 (Tex. App. 2003).

2. Contracts for deed are often referred to as a “poor man’s mortgage.” See, e.g., Ananya Roy, *Urban Informality*, 71 J. AMER. PLAN. ASS’N., 147-158 (2005); *Lewis v. Premium Inv. Corp.*, 568 S.E.2d 361, 363 (S.C. 2002).

3. See, e.g., OKLA. STAT. ANN. 16 § 11A (West 2002); FLA. STAT. ANN. § 697.01 (West 2012); 7 ILL. REAL PROP. § 38.21 (discussing case law that treats anything other than mortgage as equitable mortgage).

approach, requiring specific disclosures and allowing buyers to secure a deed by converting their contracts into a promissory note or deed of trust.<sup>4</sup>

This Article examines one hybrid system from a consumer protection perspective. Texas has a long tradition of contract for deed transactions and enacted three revisions to contract for deed legislation in 1995, 2001, and 2005, all with explicit consumer protection goals.<sup>5</sup> Protections for lease-to-own agreements were added in 2005 in recognition that buyers under contracts for deed and lease-to-own agreements suffered similar abuses. The question is whether the traditional consumer protection goals of leveling the playing field between buyers and sellers—reducing the potential for fraud and abuse, increasing protections for the buyer's equity in the home, and providing more meaningful contractual disclosures—are sufficient to resolve the abuses in the contract for deed system. This Article argues that the changes in Texas law in 1995, 2001, and 2005 created significant new protections for purchasers but created new problems and left several areas still in need of attention. Leveling the playing field, in short, was not enough.

Part II of this Article explores the current lending landscape, the history of contract for deed, and why it is still used for home financing. Part III dissects the changes to Texas contract for deed legislation in 1995, 2001, and 2005. Part IV critiques those changes from a consumer protection viewpoint, suggesting that the typical consumer protection formula failed to resolve many of the abusive practices. In the contract for deed system, leveling the playing field is about more than the negotiation between the buyer and the seller. It focuses on the buyer's right to enjoy her property—to place a lien, make home improvements, or prevent foreclosure—regardless of the type of home financing she obtained. More meaningful disclosures and penalties for deceptive practices are important corrective steps, as are automatic conversions of contract for deed into mortgages and automatic conversion of lease-to-own agreements into purchase agreements.

While this Article focuses primarily on hits and glaring misses in Texas contract for deed legislation, it also suggests a framework for looking at seller financing and residential property protection more generally. Despite significant legal protections, buyers are still losing their homes at an alarming rate and often do not recapture any of the money they have invested. If the goal of consumer protection is to balance the rights of purchasers and sellers and to maximize a homeowner's homestead rights and equity, the legislation should focus on removing barriers and artificial opt-in provisions that place less-sophisticated homeowners at a significant disadvantage.

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4. See, e.g., OHIO REV. CODE ANN. § 5313.07 (West 2006).

5. The legislative record explains the need for regulation by referring to contract for deed abuses. See, e.g., House Research Org., Bill Analysis, Tex. S.B. 629, 79th Leg., R.S. (2005) at 4-5 ("Executory contracts . . . have been used more frequently in recent years as predatory lenders prey on the immigrant, minority, and low-income populations of Texas . . . [Abuse] has come to the public's attention after thousands of people in Houston lost their homes under such contracts with a single seller.").

## II. SELLER FINANCING FOR LOW-INCOME HOMEBUYERS IN TEXAS

### *A. Problems Persist During Credit Crises Even After Consumer Protection Legislation is Enacted*

This Article reviews changes in the contract for deed laws and the attempts to curb abuses using traditional consumer protection tools. In my first year as a clinical professor at St. Mary's Law School Center for Legal and Social Justice, I encountered several contract for deed cases where a seller was taking advantage of the buyer's lack of understanding of contract terms and lack of knowledge about contract recording and deed transfer. These clients were all first-time homebuyers and native Spanish speakers, and the home values ranged from about \$20,000 to \$40,000.<sup>6</sup> Like many buyers in the subprime lending market, many had no credit history in the U.S., or as a result of poverty and financial stress had negative credit records. Having practiced housing law in New York and Massachusetts, where I focused on landlord-tenant law, I wanted to know more about this odd contract for deed system and why it seemed to be the preferred method for low-income buyers to finance a home purchase. Additionally, I wanted to know how to improve the contract for deed system for these homebuyers, so their financial and emotional investment in the home would be protected. Three cases from the St. Mary's Center for Legal and Social Justice<sup>7</sup> illustrate the range of current abuses in contracts for deed and lease-to-own agreements:

Selling to a second buyer then trying to evict: Ms. Alvarado lives with her family in Eagle Pass, Texas, on the border with Mexico. She signed a contract for deed, making a downpayment of \$1500 and paying \$400 per month for at least three years. The seller never recorded the contract for deed. In 2011, Ms. Alvarado received an eviction notice saying she would need to leave the property at the end of the month. The seller had sold the property to another buyer using another contract for deed.

Selling under a lease-to-own then evicting on a technicality: Mr. Rivera didn't consider himself a renter. Four years ago, he signed a lease agreement with option to buy, made a downpayment of \$3000, and paid installments of \$600 per month. When the seller brought a summary eviction action because Mr. Rivera had not reimbursed him for property taxes, Mr. Rivera moved to dismiss the case because he was an owner, not a renter. The Court disagreed at trial and on appeal, finding that Mr. Rivera never exercised his option to purchase. He had paid \$3000 down but had not mailed a certified letter to the seller stating he wished to purchase the

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6. Some homes cost even less. A developer in Mercedes, Texas was sued by the State Attorney General for failing to get plat approval before she sold lots for \$13,000 under contract for deed. The lots had no paved roads, and owners had to bring in their own water and use outhouses. See Lynn Brezovsky, *Valley Developer is 3<sup>rd</sup> to be Sued by State AG*, SAN ANTONIO EXPRESS NEWS, Nov. 6, 2007, at 2B.

7. All names have been changed to protect client confidentiality.



home as was specified in the contract. Mr. Rivera was evicted like any other tenant.

**Failing to record contract or turn over deed:** In 1987, Mr. Guerrero purchased a plot of land and a mobile home under a contract for deed. For fifteen years, Mr. Guerrero made all payments under the contract but never received a deed from the sellers. In 2010, he tried to get a government loan for some needed repairs, assuming his family home of twenty-three years was rightfully his. Mr. Guerrero quickly found out that he and his wife were not record owners of the home and would not get a loan without proper title. Because so much time had passed, Mr. Guerrero could not find the sellers to request title.<sup>8</sup>

Much has been written about the change in the lending landscape for nontraditional borrowers.<sup>9</sup> Lending activity has decreased, and lenders are taking a careful look at the buyer's income, employment, and credit history.<sup>10</sup> Despite the lack of credit, low-income people still have a strong desire to own homes even if traditional financing is not available.<sup>11</sup> Home ownership for low-income people has practical and emotional elements, just like for higher-income buyers. At \$400 to \$600 per month in the South Texas region, a house payment is equivalent to or less than a monthly rent payment, and owning a home is viewed

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8. A similar case was reported in a newspaper from Victoria, Texas. The Carrera family paid the balance on a contract for deed but never received title to the home. A bank sold the property at a foreclosure auction because the seller had pledged the property as collateral for a loan and then defaulted. See Allison Miles, *Jackson County Foreclosure Brings Tears, Questions*, VICTORIA ADVOC. (Sept. 1, 2009), [http://www.victoriaadvocate.com/news/2009/sep/01/am\\_home\\_080509\\_60487/?news&police-courts](http://www.victoriaadvocate.com/news/2009/sep/01/am_home_080509_60487/?news&police-courts).

9. See generally Jeffrey A. Usow & Jade Earl Newburn, *The Return of Seller Financing for Commercial Real Estate*, PROB. & PROP., Jan-Feb. 2010; Crystal Myslajek, *Risks and Realities of Contract for Deed*, CMTY. DIVIDEND (Jan. 1, 2009), [http://minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=4098](http://minneapolisfed.org/publications_papers/pub_display.cfm?id=4098) (due to tight credit market, homebuyers will have less success qualifying for mortgages, and may turn to contracts for deed).

10. See Julie Schmit, *Tight Standards Make Mortgages Tough to Get*, USA TODAY (July 14, 2011), <http://www.usatoday.com/money/economy/housing/story/2011-09-15/mortgages-tough-to-get/50405698/1> (buyers "face more demands to prove their incomes, verify assets, show steady employment and explain things such as new credit cards and small bank account deposits"); Nick Timiraos, *FHA Sets Tighter Lending Requirements*, WALL. ST. J. (Jan. 20, 2010), <http://online.wsj.com/article/SB10001424052748704320104575015013235518270.html> (tighter lending requirements for low credit scores, and an upfront insurance premium); Amy Fontinelle, *The Ins and Outs of Seller-Financed Real Estate Deals*, FORBES (Sept. 23, 2010), <http://www.forbes.com/sites/investopedia/2010/09/23/the-ins-and-outs-of-seller-financed-real-estate-deals/>; Jeff Brown, *Is Seller-Financing Right for You?*, MSN (Aug. 15, 2011), <http://money.msn.com/home-loans/is-seller-financing-right-for-you-mainstreet.aspx> ("buyers are skittish, lenders are stingy, and appraisers can be downright picky").

11. See Heather K. Way, *Informal Homeownership in the United States and the Law*, 29 ST. LOUIS U. PUB. L. REV. 113, 126 (2009) (quoting Nicolas P. Retsinas & Eric S. Belsky, *Examining the Unexamined Goal*, in LOW-INCOME HOMEOWNERSHIP: EXAMINING THE UNEXAMINED GOAL 1, 11 (2002) ("the desire to own a home is 'almost a genetic yearning . . . to claim and fence and demarcate our dwellings, physically and legally, from others.'")); see also Emily Badger, *The Anxiety of the Forever Renter*, ATLANTIC CITIES (Nov. 14, 2011), <http://www.theatlanticcities.com/housing/2011/11/forever-renter/484/> ("I can't help but wonder . . . if this [home ownership] dream doesn't belong to a bygone industrial era.' He sounds so convincing. All of this does. Still, I can't get over this feeling: I want one anyway").



as major part of the American dream. Especially for many immigrant communities, "it is a powerful symbol of self-reliance, personal dignity, and family advancement."<sup>12</sup> The benefits of home ownership extend to the wider community as well: "secure land tenure (e.g. fee simple ownership) is empirically associated with greater investment in home improvement and, where owners build their own homes, with greater investment in initial home construction."<sup>13</sup>

### *B. How Contracts for Deed and Lease-to-Own Agreements Work*

For low-income buyers who do not meet bank-lending requirements, seller financing may be the only way to finance a home purchase.<sup>14</sup> Sellers commonly use contracts for deed to contract home sales in Texas and other jurisdictions where there is available land and many buyers are ineligible for bank financing.<sup>15</sup> Purchasing a home under contract for deed seems relatively simple—it requires none of the inspections, credit verifications, and closing formalities associated with traditional mortgages.<sup>16</sup> Sellers and buyers can complete a deal in a very short period of time: really, just as long as it takes to make a downpayment and sign a two-page contract. Some contracts may even consist of an oral agreement and a handshake.<sup>17</sup>

Here is how contract for deed works: an executory contract for the conveyance of land, also called a "contract for deed" or "installment land contract," is an agreement where the purchaser takes possession of property, makes installment

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12. Jane E. Larson, *Free Markets Deep in the Heart of Texas*, 84 GEO. L.J. 179, 206 (1995); Peter M. Ward, *El Titulo en la Mano: The Impact of Titling Programs upon Low Income Housing in Texas Colonias*, 36 LAW & SOC. INQUIRY, Winter 2011, at 1, 10 ("Colonia residents . . . actively and deliberately trade-off distant location, poor services, and the absence of city amenities, in order to break into the property market as homesteaders. They seek to share in the American 'Dream' and to build equity and a future patrimony for their children."); *id.* at 14 ("many commented that they now felt that they could hold up their heads when dealing and interacting with government officials, with banks, or with formal institutions.").

13. See Larson, *supra* note 12, at 240.

14. See Way, *supra* note 11, at 127-28 ("With the tightening of the housing mortgage market in 2008 and 2009, the informal market will likely serve a growing number of low-income and credit-burdened households and provide them with the only access they have to become homeowners.").

15. See *id.* at 129; Roy, *supra* note 2, at 147.

16. See Eric T. Freyfogle, *The Installment Land Contract as Lease: Habitability Protections and the Low-Income Purchaser*, 62 N.Y.U. L. REV. 293, 305 (1987).

17. St. Mary's Center for Legal and Social Justice reviewed many very informal contracts for deed, including one handwritten in Spanish, one without any payment terms, and several without a legal description of the land purchased. Sometimes the buyer's best evidence of the agreement is payment receipts, which they usually know to keep in a safe place. See also PETER M. WARD, HEATHER K. WAY & LUCILLE WOOD, THE CONTRACT FOR DEED PREVALENCE PROJECT: A FINAL REPORT TO THE TEXAS DEPARTMENT OF HOUSING AND COMMUNITY AFFAIRS 2:5 (2012), available at <http://www.tdhca.state.tx/housing-center/docs/CFD-Prevalence-Project.pdf>.

payments to the seller, and does not receive title until the balance is paid in full.<sup>18</sup> Through much of the twentieth century, contracts for deed were the most common substitute for a mortgage or deed of trust.<sup>19</sup> They were used for large and small land purchases of both farm and residential property.<sup>20</sup> Contracts for deed are often found in states where only judicial foreclosure is available because it allows a defaulting party to be removed from property without a cumbersome judicial foreclosure.<sup>21</sup> Other states, like Texas, allow non-judicial foreclosure but still have a long history of seller-financed transactions through contracts for deed.<sup>22</sup>

In the last sixty years, contracts for deed became concentrated in low-income communities where homes are affordable<sup>23</sup> but traditional mortgage financing is not available.<sup>24</sup> In Texas, contract for deed transactions are common in low-income communities, especially along the Texas-Mexico border.<sup>25</sup> In the contract for deed cases litigated by St. Mary's Center for Legal and Social Justice, home prices are much lower than in other parts of the United States, in the range of \$40,000 for a three-bedroom home. Downpayments range from 5% to 10% of the total purchase price, perhaps as an indication that sellers require

18. See RESTATEMENT (THIRD) OF PROP.: MORTG. § 3.4 cmt. a (2009); WILLIAM V. DORSANEO III, TEXAS LITIGATION GUIDE, REAL ESTATE SALES CONTRACTS § 252.01[2][a] (2012).

19. See Grant S. Nelson, *The Contract for Deed as a Mortgage: The Case for the Restatement Approach*, 1998 BYU L. REV. 1111, 1112 (1998) (describing historical foundations of contracts for deed); GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 116 (5th ed. 2007).

20. See Margaret Rosso Grossman & Keith G. Meyer, *Agricultural Credit Institutions, Operations, and Guarantees in the United States*, 46 AM. J. COMP. L. 275, 280 (1998); Shelayne Clemmer, *Texas's Attempt to Mitigate the Risks of Contracts for Deed—Too Much for Sellers—Too Little for Buyers*, 38 ST. MARY'S L.J. 755, 756-58 (2007).

21. See RESTATEMENT (THIRD) OF PROP.: MORTG. § 3.4 cmt. a (2009).

22. There are reported contract for deed cases from the early twentieth century. See *Hughes v. Burton Lumber Corp.*, 188 S.W. 1022 (Tex. Civ. App. 1916); see also John Mixon, *Installment Land Contracts: A Study of Low Income Transactions, with Proposals for Reform and a New Program to Provide Home Ownership in the Inner City*, 7 HOUS. L. REV. 523 (1970).

23. In Texas, for example, contracts for deed are located in "colonias" along the Texas-Mexico border, and Latino enclaves in urban areas. See Way, *supra* note 11, at 130; FED. RES. BANK OF DALLAS, TEXAS COLONIAS: A THUMBNAILED SKETCH OF THE CONDITIONS, ISSUES, CHALLENGES, AND OPPORTUNITIES 7 (2002) ("Since the 1950s, the contract for deed has been the most frequently used financing mechanism in the colonias because many individuals have neither a credit history nor the resources to qualify for traditional bank or credit union financing.").

24. See Way, *supra* note 11, at 127-128 ("With the tightening of the housing mortgage market in 2008 and 2009, the informal market will likely serve a growing number of low-income and credit-burdened households and provide them with the only access they have to become home owners."); Freyfogle, *supra* note 16, at 304; Clemmer, *supra* note 20, at 761 (noting contract for deed transactions are an alternative to traditional real estate financing methods, usually for "low-capital and low-income purchasers").

25. A recent study found that along the Texas border and in informal homestead communities, only 11.7% of buyers purchased property with traditional financing. See WARD, WAY & WOOD, *supra* note 17, at 6:1; see also FED. RES. BANK OF DALLAS, *supra* note 23, at 3 ("People often buy the lots through a contract for deed, a property financing method whereby developers typically offer a low downpayment and low monthly payments but no title to the property until the final payment is made.").

some commitment to the property before entering into a long-term contract with the buyer.<sup>26</sup>

Since low income is one of the main reasons to enter into a contract for deed in the first place, buyers seldom request (nor do they know about) many of the safeguards banks require, such as inspections, appraisals, and title policies.<sup>27</sup> Buyers have no access to real estate treatises, for example, which counsel buyers to conduct a title search, record a document in the title records notifying third parties of the purchase, include a provision in the contract that liens may not be placed on the property, conduct an annual title search to check for liens against the property, and place the deed in escrow so that it may be delivered after all payments have been made.<sup>28</sup> Consequently, title problems and substandard housing are common in contract for deed transactions.<sup>29</sup>

For these reasons, contract for deed is regarded as a "seller-favorable approach."<sup>30</sup> For the seller, the attraction of the contract for deed is twofold: it has a powerful forfeiture remedy, allowing the seller to immediately declare a breach for failure to make a payment.<sup>31</sup> Under current Texas law, if a buyer has paid less than 40% of the purchase price or less than forty-eight months under the contract, the seller retains all payments in the event of default, no matter the current value of the property.<sup>32</sup> A second and perhaps more important attraction to the seller is the ability to sell property that is low value or in need of repairs without the expenses of a real estate broker or title company. Interest

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26. *But cf.* Freyfogle, *supra* note 16, at 308 (arguing contract for deed holders should benefit from the same habitability protections as tenants, in part because these buyers make minimal downpayments and have little equity in their homes).

27. *See id.* at 305 ("The typical installment contract home buyer has long appeared to courts as a poorly advised, poorly protected, often lower-income purchaser . . . Because they do not obtain outside financing, they do not benefit from the precautions demanded by typical mortgage lenders: inspections, appraisals, title reports, termite certificates, and other evidence of a property's value."); Way, *supra* note 11, at 116-117 (explaining that the United States has formal and informal pathways to home ownership, providing good, marketable title to traditional buyers, and "reduced legal protections and insecure, unmarketable title" to buyers who use more informal methods).

28. *See* RICHARD R. POWELL & PATRICK J. ROHAN, *POWELL ON REAL PROP.* § 37.21[1][b] (1997).

29. *See* Nelson, *supra* note 19, at 1142-44; NAT'L CONSUMER LAW CTR., *FORECLOSURES* 461 (4th ed. 2012) (explaining that contracts for deed often are "abusive alternatives to mortgages or deeds of trust"); *id.* at 463 ("While installment land sales contracts are not always abusive, at their worst they can be a vehicle for scams, particularly in neighborhoods where housing values are shrinking, or in connection with sales of manufactured housing that is depreciating in value. In these situations the contracts are often the functional equivalent of leases.").

30. *See* POWELL & ROHAN, *supra* note 28, at [1][a].

31. *See* Larson, *supra* note 12, at 209 ("The risk of instantaneous dispossession for missing one or two payments threatens colonia householders throughout the duration of the contract. Anecdotal evidence suggests that such forfeitures are not uncommon."); *see also* Mixon, *supra* note 22, 551 (explaining that sellers may prefer contract for deed over mortgage because a low-income purchaser is less likely to be able to cure a default and stop a foreclosure).

32. *See* TEX. PROP. CODE ANN. § 6.066 (West 2006).



rates are usually higher than a commercially financed mortgage.<sup>33</sup>

### III. CHANGES TO CONTRACT FOR DEED LAWS AIMED AT CONSUMER PROTECTION

Abuses in the contract for deed system have been highlighted for many years,<sup>34</sup> but at least in Texas the first overhaul of the contract for deed system took place in 1995. The 1995 legislation was explicit in its consumer protection orientation, enacted to prevent further expansion of substandard buildings and inadequate infrastructure.<sup>35</sup> It required the seller to disclose certain terms, such as written notice of property conditions,<sup>36</sup> a right to cancellation within two weeks of the deal,<sup>37</sup> and an annual accounting.<sup>38</sup> It also required the seller to record the executory contract with the county clerk and to transfer title within thirty days of receiving the last payment.<sup>39</sup> Interestingly, although the 1995 legislation was designed to help low-income buyers, one author notes that initially the legislation was “opposed by organizations representing the interests of the very poor, which feared the closing of this market in low-income housing.”<sup>40</sup>

Some buyers also received increased protections in the event of default. For buyers who paid over 40% of the amount due under the contract for deed, sellers could not enforce the remedy of forfeiture and acceleration.<sup>41</sup> Rather, sellers were

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33. See, e.g., TEX. CMTY. BUILDING WITH ATTORNEY RES., LEGAL GUIDE TO CONVERTING CONTRACTS FOR DEED 2 (2006), [http://texasbar.org/content/legal\\_library/pubs/downloads/ConvertingContractsForDeed2006.pdf](http://texasbar.org/content/legal_library/pubs/downloads/ConvertingContractsForDeed2006.pdf).

34. See, e.g., Mixon, *supra* note 22, at 536 (“[T]he installment land contract buyer has virtually no institutional protection. Government has for the most part ignored him; there is no mortgagee to protect him; the market is tight because the commodity, low income housing, is scarce; and finally, most of the legal institutions work in favor of the contract vendor.”).

35. See, e.g., House Research Org., Bill Analysis, Tex. S.B. 629, 79th Leg., R.S. (2005) at 4-5; see also Shook v. Walden, 368 S.W.3d 604, 625 (Tex. App. 2012) (stating that provisions in contract for deed laws that do not apply to regular mortgages include the notice of right to cure, the right to a public sale after 40% of the purchase price is paid, and the right of rescission).

36. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 3, 1995 Tex. Gen. Laws 4982, 4984 (current version at TEX. PROP. CODE ANN. § 5.008 (West 2011)) (requiring seller to include a current survey of the property—one completed within the past year of signing—and a copy of any restrictive covenants and easements that affect title to the property).

37. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 3, 1995 Tex. Gen. Laws 4982, 4986 (current version at TEX. PROP. CODE ANN. § 5.008 (West 2011)) (“The [buyer] may cancel and rescind an executory contract for any reason by sending by telegram or certified or registered mail, return receipt requested, or by delivering in person a signed, written notice of cancellation to the seller not later than the 14<sup>th</sup> day after the date of the contract.”). Specific cancellation language is provided in the statute.

38. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 3, 1995 Tex. Gen. Laws 4982, 4987 (current version at TEX. PROP. CODE ANN. § 5.077 (West 2011)) (requiring that an annual accounting statement be provided every January for the duration of the executory contract, including “the amount paid under the contract, the remaining amount owed under the contract, the number of payments remaining under the contract, and the amounts paid to taxing authorities on the purchaser’s behalf if collected by the seller”).

39. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 3, 1995 Tex. Gen. Laws 4982, 4987-88 (current version at TEX. PROP. CODE ANN. §§ 5.076, 5.079 (West 2011)).

40. Larson, *supra* note 12, at 202.

41. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 3, 1995 Tex. Gen. Laws 4982, 4987 (current version at TEX. PROP. CODE ANN. § 5.066 (West 2006)).

required to sell the property in a manner similar to a foreclosure sale.

The 1995 legislation applied only to designated counties along the Texas-Mexico border, where the legislature believed the abuses were most common.<sup>42</sup> The legislature was right about the abuses: there, developers sold plots of land in unincorporated subdivisions called colonias, which lacked utility or sewer service.<sup>43</sup> Harsh living conditions in some colonias are the subject of much economic development work and scholarly debate.<sup>44</sup>

But contracts for deed are not limited to colonias or rural areas along the border, as the examples described above demonstrate.<sup>45</sup> In 2001, after a tornado in Tarrant County, Texas (near Fort Worth), the legislature learned that many homeowners had contracts for deed and were prone to the same abuses as were buyers along the Texas-Mexico border.<sup>46</sup> The Texas legislature extended protections statewide, made changes related to disclosure and cure provisions in executory contracts, and created penalties for noncompliance. Sellers were required to disclose tax information, insurance coverage, and more information in the annual accounting.<sup>47</sup> Failure of the seller to comply with the tax and insurance provisions was a "false, misleading, or deceptive act or practice" under the Texas Deceptive Trade Practices Act.<sup>48</sup> Failure to procure an annual accounting statement made the seller liable for damages and attorneys' fees.<sup>49</sup> A

42. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 2, 1995 Tex. Gen. Laws 4982; HOUSE RESEARCH ORG., BILL ANALYSIS: S.B. 336, at 1 (Tex. 1995) (stating colonia residents' per capita income and unemployment rate average 25% below state average).

43. See ENVTL. PROT. AGENCY, COLONIAS FACTS 1 (2003), available at <http://www.epa.gov/owm/mab/mexican/clnfcts.pdf>.

44. Compare Richard Delgado, *Rodrigo's Twelfth Chronicle: The Problem of the Shanty*, 85 GEO. L.J. 667 (1997) with Larson, *supra* note 12, and Jane E. Larson, *Informality, Illegality, and Inequality*, 20 YALE L. & POL'Y REV. 137 (2002).

45. See Way, *supra* note 11, at 130 ("... in Texas, installment contract purchases are common in Latino immigrant communities in places such as Houston, peri-urban neighborhoods outside of Austin, and in unincorporated 'colonias'"); see, e.g., *Morton v. Hung Nguyen*, 369 S.W.3d 659 (Tex. App. 2012); *NETCO, Inc. v. Montemayor*, 352 S.W.3d 733 (Tex. App. 2011); *Sluder v. Ogden*, No. 03-10-00280-CV, 2011 WL 116058 (Tex. App. Jan. 13, 2011); *Sonnier v. Sonnier*, 311 S.W.2d 211 (Tex. App. 2011); *Norton v. Norton*, No. 07-08-0469-CV, 2010 WL 2816212 (Tex. App. July 19, 2010); *Ward v. Malone*, 115 S.W.3d 267 (Tex. App. 2003); *Texas Best Mortgage v. Nieves*, No. 04-03-00097-CV, 2003 WL 22489727 (Tex. App. Nov. 5, 2003); *Caperton Realty Svs., Inc. v. Shamblin*, No. 05-00-00750-CV, 2001 WL 605193 (Tex. App. June 5, 2001) (not designated for publication).

46. See Chris Vaughn, *Storm Victims Say Home Deals Unfair*, FT. WORTH STAR-TELEGRAM, Feb. 24, 2001, at B1 (after a tornado, owners realized "[b]ecause of vague contracts, oral agreements, no insurance policies on some houses, uncooperative home sellers and a language barrier, repairs to the houses went undone for months, and home buyers said they were threatened with eviction. Many repairs were eventually done by charity groups.")

47. See Act of May 22, 2001, 77th Leg., R.S., ch. 693, § 1, 2001 Tex. Gen. Laws 1319, 1323, 1327 (current version at TEX. PROP. CODE ANN. § 5.070 (West 2006)) (seller must present tax certificate showing amount of taxes owed on the property, copies of any insurance policies on the property, and on the accounting statement, the amount paid to insure the property, any insurance proceeds applied to the property, and a legible copy of the current insurance policy if the seller changed policies.)

48. See TEX. PROP. CODE ANN. § 5.070(b) (West 2006).

49. See Act of May 22, 2001, 77th Leg., R.S., ch. 693, § 1, 2001 Tex. Gen. Laws 1319, 1323, 1327 (current version at TEX. PROP. CODE ANN. §§ 5.070, 5.078 (West 2006)) (damages are \$250 per day until

prohibition on oral agreements was added.<sup>50</sup> Harsh penalties were applied if the seller did not transfer title to the property within thirty days of last payment.<sup>51</sup> The 2001 legislation also expanded protections to all non-English-speaking buyers (not just Spanish speakers), requiring contracts for deed to be written in the same language used in the negotiations.<sup>52</sup>

The last significant changes to contract for deed legislation occurred in 2005, when the legislature allowed a buyer to convert her contract for deed into recorded, legal title at any time during the contract period. The legislature intended to grant executory contract homebuyers “the same rights and benefits that home owners have in any other type of home buying arrangement.”<sup>53</sup> Under the terms of Property Code § 5.081, a buyer could deliver a promissory note to the seller with the same interest, due dates, and fees, and the buyer would execute a deed conveying title to the buyer.<sup>54</sup> The 2005 legislation also required the seller to keep the property free of liens.<sup>55</sup>

Texas recognizes the benefits of the conversion process enacted in 2005 and the need for lawyers to do conversions. It continues to appropriate millions of dollars in public funds to do contract for deed conversions.<sup>56</sup> Public interest organizations and the private bar also volunteered to clear title to lots and convert

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an accounting statement is provided); Mike Lee, *Contracts for Deed: Extinction Long Overdue*, 37 TEX. TECH. L. REV. 1231, 1243 (2005).

50. See Act of May 22, 2001, 77th Leg., R.S., ch. 693, § 1, 2001 Tex. Gen. Laws 1319, 1324 (Vernon) (current version at TEX. PROP. CODE ANN. § 5.072 (West 2006)) (all executory contracts and changes made to the agreement must be made “in writing and signed by the party to be bound”).

51. After thirty-one and before ninety days, the seller is liable for \$250 each day he does not transfer title to the buyer. After ninety days, the rate increases to \$500 per day. See TEX. PROP. CODE ANN. § 5.079 (West 2006).

52. The previous legislation referred to a “Spanish Language Requirement” when negotiations were conducted in Spanish. The 2001 legislation expanded the protection as a “Foreign Language Requirement.” See Act of May 22, 2001, 77th Leg., R.S., ch. 693, § 1, 2001 Tex. Gen. Laws 13 (current version at TEX. PROP. CODE ANN. § 5.068 (West 2006)).

53. See Senate Research Center, Author’s/Sponsor’s Statement, Tex. H.B. 1823, 79th Leg., R.S. (2005).

54. See Act of May 24, 2005, 79th Leg., R.S., ch. 978, § 4, 2005 Tex. Gen. Laws 3280, 3282 (current version at TEX. PROP. CODE ANN. § 5.081(c) (West 2006)). (The promissory note must be equal to the amount owed on the executory contract including interest, due dates, and late fees). After the buyer initiates her option to purchase, Chapter 92 of the Property Code [landlord-tenant law] no longer applies. See TEX. PROP. CODE ANN. § 5.0621 (West 2006); see also TEX. PROP. CODE ANN. § 5.081(d) (West 2006) (The seller must execute the recorded deed conveying legal title to the buyer within ten days).

55. See TEX. PROP. CODE ANN. § 5.085(b) (West 2006) (seller is required to maintain fee simple free from any encumbrances for duration of contract unless buyer agrees to accept property where the lien resulted in the past from the seller obtaining a loan to purchase the property or if the buyer agrees that an encumbrance may be placed to obtain a loan to make improvements to the property).

56. A spokesman for the Texas Department of Housing and Community Affairs (TDHCA) said the agency has done 848 conversions at a cost of \$14.1 million. See Richardo Gandara, *Informal Contracts Still Put Many Texas Homeowners at Risk, UT Study Shows*, AUSTIN AM. STATESMAN (Oct. 21, 2012), <http://www.statesman.com/news/news/informal-contracts-still-put-many-Texas-homeowners/nSh5D/>. The TDHCA helped fund a recent study to investigate why funds set aside for contract for deed conversion were not fully expended. See Andrew Kreighbaum, *Colonia Law*, LAREDO MORNING TIMES, Jan. 11, 2012.



contracts for deed.<sup>57</sup>

The 2005 legislation also took on lease-to-own agreements, which are recognized to have even more pitfalls for the buyer than contract for deed.<sup>58</sup> The changes expanded the definition of executory contract to include "[a]n option to purchase real property that includes or is combined . . . with a residential lease agreement, together with the lease."<sup>59</sup> After a buyer has exercised an option to purchase under the agreement, the executory contract is no longer subject to landlord-tenant provisions of Chapter 92 of the Texas Property Code.<sup>60</sup> Presumably, exercising the option changes a person's status from renter to owner.

The 2005 legislation strengthened protections relating to language and execution of an executory contract. A seller is required to list in the contract: a description of the property, the buyer's right to an annual accounting statement, and remedies available to the buyer if an accounting statement is not provided.<sup>61</sup> A seller cannot place any liens on the property if the liens are not previously disclosed in the contract, and the seller must "state that the property has been lawfully subdivided and platted."<sup>62</sup>

#### IV. REVIEWING CONTRACT FOR DEED LEGISLATION USING A CONSUMER PROTECTION ANALYSIS

Consumer protection aims for "efficiency and equity in the marketplace," typically by regulating transactions between more-sophisticated sellers and less-sophisticated buyers.<sup>63</sup> Consumer statutes aim to level the field with a mix of disclosures, increased access to credit, and penalties for unfair practices.<sup>64</sup> This balance between buyers and sellers is particularly important when the transaction is a home, often the most meaningful, and certainly most expensive, consumer purchase of one's lifetime.<sup>65</sup>

57. See, e.g., Pamela Brown, *Lawyers Team Up to Help in Colonia*, 63 TEX. B.J. 462, 463 (2000).

58. See Way, *supra* note 11, at 139 (noting that lease-to-own homebuyers enjoy far fewer protections than mortgagors).

59. Act of May 24, 2005, 79th Leg., R.S., ch. 978, § 4, 2005 Tex. Gen. Laws 3280, 3281 (West) (current version at TEX. PROP. CODE ANN. § 5.062(a)(2) (West 2006)).

60. See *id.*

61. See HOUSE RESEARCH ORG., BILL ANALYSIS, Tex. S.B. 629, 79th Leg., R.S., at 2 (2005).

62. *Id.*

63. See Stephen Brobeck & Robert J. Hobbs, *The Consumer Movement*, in NAT'L CONSUMER LAW CTR., THE PRACTICE OF CONSUMER LAW: SEEKING ECONOMIC JUSTICE 5 (2d ed. 2006).

64. See JOHN A. SPANOGLE JR. ET AL., CONSUMER LAW: CASES AND MATERIALS li-liv (3d ed. 2007); Carolyn Carter & Kathleen Keest, *Analysis of Consumer Transactions*, in NAT'L CONSUMER LAW CTR., THE PRACTICE OF CONSUMER LAW: SEEKING ECONOMIC JUSTICE 95 (2d ed. 2006).

65. See DAVE SACKETT & KATIE HANDELL, THE TARRANCE GROUP, KEY FINDINGS FROM NATIONAL SURVEY OF VOTERS 4 (2012), available at [http://www.wilsoncenter.org/sites/default/files/key\\_findingsfromsurvey\\_1.pdf](http://www.wilsoncenter.org/sites/default/files/key_findingsfromsurvey_1.pdf) (63% of surveyed likely voters viewed home ownership as "extremely important"); Edward N. Wolff, *Recent Trends in Household Wealth in the United States: Rising Debt and the Middle-Class Squeeze—an Update to 2007*, at 8 (Levy Economics Inst., Working Paper No. 589,

Since 1995, contract for deed statutes in Texas have used a mix of traditional consumer protection tools, including disclosure requirements and penalties for unfair practices. To be sure, the current system offers many more protections to the buyer than the pre-1995 regime, assuming the buyer knows what terms to expect and how to protect her rights when the contract for deed is drafted. The buyer is also in a better position, as a result of the 2005 amendments, if she has the wherewithal to convert the contract for deed into a promissory note.

The problem is that many buyers, like Ms. Alvarado and Mr. Guerrero, do not know about the disclosure and reporting requirements in the law, nor do they know how to convert the contract for deed into a promissory note during the term of the contract. Dishonest sellers continue to use contract for deed as a way to get a lump-sum downpayment and engineer a quick eviction.<sup>66</sup> There are few legal services lawyers to represent clients in eviction or foreclosure proceedings and even fewer to help homeowners convert contracts for deed into promissory notes.<sup>67</sup>

Traditional consumer protection analysis focuses on the pre-sale negotiation between buyer and seller—a sensible approach because in many consumer transactions the relationship of the buyer and seller ends when the sale is completed. But in a contract for deed, the relationship between buyer and seller continues for years. So, what takes place after the sale, especially in terms of buyer protection, is equally as important as the pre-sale negotiation. After the sale is complete, a buyer under contract for deed should enjoy the same property rights as other homeowners; after all, contract for deed is just a financing mechanism for people without traditional credit. The buyer's contractual and financial commitment to the home (through downpayment, monthly payments, tax payments, etc.) is identical to a traditional bank mortgage.

This Article suggests that, in addition to beefing up disclosures and penalties, contract for deed legislation should remove as many barriers as possible for a buyer to enjoy rights and benefits equal to other homeowners. In short, contracts for deed should be considered mortgages at the outset, or after buyers have made downpayments or payments equivalent to the financial investment of other mortgage holders.

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2010), available at [http://www.levyinstitute.org/pubs/wp\\_589.pdf](http://www.levyinstitute.org/pubs/wp_589.pdf) (houses comprise the largest source of wealth for most middle-income Americans).

66. See NAT'L CONSUMER LAW CTR., FORECLOSURES 463 (4th ed. 2012) (in some cases, "[s]ellers anticipate that forfeiture will occur before the buyer builds up any equity").

67. The American Bar Association estimates that only 1% of attorneys nationwide work for legal aid or the public defender. See AMERICAN BAR ASS'N, LAWYER DEMOGRAPHICS (2012), available at [http://www.americanbar.org/content/dam/aba/migrated/marketresearch/PublicDocuments/lawyer\\_demographics\\_2012\\_revised.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/marketresearch/PublicDocuments/lawyer_demographics_2012_revised.authcheckdam.pdf).

*A. Treat Contract for Deed as a Mortgage at Contract Inception or After Buyer Has Paid a Small Percentage of the Amount Due*

If a buyer defaulted on payments under the pre-1995 contract for deed system, the seller could keep all the payments, no matter how many years or how much money the buyer had paid for the home.<sup>68</sup> There was no requirement to transfer title to the home until all payments under the contract were complete.<sup>69</sup> In 1995, recognizing the potential of forfeiture after a buyer put substantial equity into her home, the legislature provided some equity protection to buyers, forbidding sellers from exercising rescission or forfeiture and acceleration when the buyer had paid "40% or more of the amount due"<sup>70</sup> or the equivalent of 48 monthly payments.<sup>71</sup> After the 40% threshold, the property may be sold using a similar process to non-judicial foreclosure,<sup>72</sup> allowing those buyers to enjoy many of the (albeit still limited) rights of a traditional mortgage holder.

Contract for deed, of course, is not the only way for a seller to finance a home sale. The seller can also create a mortgage and deed of trust, giving title to the buyer at the outset. For the buyer, a mortgage has advantages over a contract for deed because the buyer enjoys the same rights and obligations as any bank mortgagee and the protection of homestead laws.<sup>73</sup> If the home goes into foreclosure, any surplus from the sale goes to the buyer.<sup>74</sup> Recognizing the increased protections of a promissory note, deed of trust, and title, the 2005 legislation created a powerful new right for contract for deed buyers, allowing them to assume the rights of mortgage holders any time after signing a contract for deed. Conversion gives the seller a promissory note and the homeowner the deed without the need to pay 40% or more of the purchase price. Here is how the conversion process works: first, the buyer must find out the balance due on the property, using her own records or requesting a balance from the seller.<sup>75</sup> The buyer must draft a promissory note with the same monthly payments, due dates, interest rates, and applicable late fees and penalties as in the original executory contract.<sup>76</sup> After the buyer delivers a promissory note, the seller must execute a

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68. See TEX. PROP. CODE ANN. § 5.062 (West 1995).

69. See *id.* § 5.061.

70. It is unclear how "amount due" is calculated, considering that most contracts for deed are interest bearing.

71. See Act of May 27, 1995, 74th Leg., R.S., ch. 994, § 5.101, 1995 Tex. Gen. Laws 4982, 4987 (current version at TEX. PROP. CODE ANN. § 5.066(a) (West 2006)).

72. See *id.* at 4987-88.

73. See POWELL & ROHAN, *supra* note 28, at § 37.21[1][a] (the mortgage or deed of trust "is a definite advantage to both the seller and the purchaser because their rights and obligations are set by the same statutory scheme that applies to financing provided by banking and thrift institutions in the community").

74. In practice, of course, there is rarely a surplus after a foreclosure sale. See *Mixon, supra* note 22, at 549 (a deed of trust is preferable to an installment contract even in non-judicial foreclosure state because surplus at sale goes to the mortgagor).

75. See TEX. PROP. CODE ANN. § 5.082(a), (c) (West 2006).

76. See *id.* § 5.081(c).



deed containing any warranties required by the contract and conveying recorded, legal title to the property.<sup>77</sup> At the same time the seller executes a deed, he must execute a deed of trust containing the same terms as the executory contract.<sup>78</sup>

From a consumer protection viewpoint, the problem is not what the conversion achieves but the process: requiring the buyer to take complicated legal steps to assert her rights. Given the need to draft a promissory note and make written compliance demands upon the seller, it is simply unrealistic to expect a low-income buyer to convert a contract for deed without a lawyer's help. By requiring the least-sophisticated party to take steps to get an important benefit, the conversion process creates unnecessary hurdles and disadvantages for homeowners who cannot afford or access lawyers.<sup>79</sup> Conversion is expensive whether the buyer pays for an attorney or the state provides legal aid grants for conversion programs.<sup>80</sup>

A fair conversion process should not need to rely on affirmative steps by the buyer and the help of a skilled attorney. A much simpler law would convert contract for deed to a mortgage automatically either at contract inception or after a small amount of the purchase price has been paid.<sup>81</sup> Then, a buyer under contract for deed would have the same rights and protections as a mortgage holder, reflecting the equivalent financial investment in their homes. For example, after paying \$1500 down and \$400 per month for three years, there would be no question that Ms. Alvarado held a mortgage on her home and had superior rights to a third party who was trying to purchase the home and evict her as a "renter." If she defaulted on her payments or other terms of the contract for deed, the seller's recourse would be through traditional foreclosure processes, not a quick eviction and re-sale to a third party. These automatic protections would also apply in situations where a downpayment was made and the parties move in, but for whatever reason the title is not transferred.<sup>82</sup>

Many commentators, including the Restatement on Property, have urged for contracts for deeds to be treated as mortgages with the goal of eliminating contract for deed as a method of real estate financing.<sup>83</sup> These authors point out that contract for deed legislation puts a "legislative imprimatur on the forfeiture

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77. See *id.* § 5.081(c)(1).

78. See *id.* § 5.081(c)(2)(A).

79. See AMERICAN BAR ASS'N, *supra* note 67.

80. See Gandara, *supra* note 56.

81. This approach is endorsed by the Contract for Deed Prevalence Project. See WARD, WAY & WOOD, *supra* note 17, at 6:11.

82. See, e.g., *Flowers v. Zuniga*, No. 11-06-00144-CV, 2008 WL 1723225 (Tex. App. April 10, 2008) (holding contract for deed protections applied to buyer who made downpayment and moved in, but did not close according to the sales contract). To people familiar with real estate transactions and the closing process, it may seem far-fetched that a buyer would not know that a closing is an essential part of the transaction. But for many first-time and low-income buyers, the downpayment and move in are all that they think they need to complete a home sale. Our legal clinic represented two families in the past year with similar stories to the *Zuniga* case.

83. See, e.g., RESTATEMENT (THIRD) OF PROP.: MORTG. § 3.4 (1997); Nelson, *supra* note 19.

concept," allowing a seller to avoid the buyer's equity of redemption and greater protections available in mortgage foreclosure.<sup>84</sup> A uniform approach to mortgages and contracts for deed is also easier for courts, so they do not have to deal with two separate types of property interests.<sup>85</sup> In Texas, for example, different rules apply to contracts before and after 40% of payments are made.

Some states follow the Restatement approach and interpret all contract for deed transactions as constructive mortgages.<sup>86</sup> This is viewed as a more efficient and equitable system for sellers, buyers, and the courts.<sup>87</sup> Other states maintain a hybrid system like Texas but have a lower threshold for equity protection, requiring mortgage foreclosure procedures after 20% of the purchase price is paid.<sup>88</sup> Both of these systems are preferable to Texas', where a buyer's equity is protected only after 40% of the purchase price is paid and the buyer's right to convert her status into mortgagee depends on her initiative in finding a lawyer to convert her contract into a mortgage.

There are arguably some drawbacks to treating all contracts for deeds as mortgages. Sellers do not want to lose the right to a quick forfeiture if the buyer

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84. See, e.g., RESTATEMENT (THIRD) OF PROP.: MORTG. § 3.4 (1997); Nelson, *supra* note 19, at 1113.

85. Courts in Texas interpret contracts for deed formalistically, often stating that they cannot look beyond the "four corners of the contract." See, e.g., *Gordon v. W. Hous. Trees, Ltd.*, 352 S.W.3d 32, 43 (Tex. App. 2011) ("the primary duty of the court in construing a deed is to ascertain the intent of the parties from all of the language in the deed within the four corners of the instrument"); Meredith R. Miller, *Contract Law, Party Sophistication, and the New Formalism*, 75 MO. L. REV. 493, 536 (2010) (critiquing rise in formalistic interpretation, and arguing for more procedural and substantive fairness for unsophisticated parties). This can be a problem for contract for deed holders, who are the less-sophisticated party and often report extra-contractual promises and inducements. Making the system uniform would allow judges to apply well-established mortgage law in almost all cases, making any representations by the seller less relevant (for example, telling the buyer that she was buying a home, when she was really signing a lease-to-own).

86. See FL. STAT. ANN. § 697.01 (West 2012) ("All conveyances . . . or other instruments of writing conveying or selling property . . . shall be deemed and held mortgages."); OKLA. STAT. ANN. tit. 16 § 11A (West 2012) ("All contracts for deed for purchase and sale of real property made for the purpose or with the intention of receiving the payment of money and made for the purpose of establishing an immediate and continuing right of possession of the described real property . . . shall to that extent be deemed and held mortgages, and shall be subject to the same rules of foreclosures . . . as are prescribed in relation to mortgages."); 7 ILL. REAL PROP. § 38.21 (discussing case law that treats anything other than mortgage as equitable mortgage, if the contract makes property security for a debt); NELSON & WHITMAN, *supra* note 19, at 122 (describing how Maryland and other states regularly contract for deed in the residential context).

87. See NELSON & WHITMAN, *supra* note 19, at 149 (noting that some courts treat installment contracts like mortgages and others treat them as contracts, resulting in "an often-confusing amalgam of contract and mortgage law").

88. OHIO REV. CODE ANN. § 5313.07 (West 2012) ("If the vendee . . . has paid . . . for a period of five years or more . . . or has paid toward the purchase price a total sum equal to or in excess of twenty percent thereof, the vendor may recover possession of his property only by use of a proceeding for foreclosure and judicial sale . . ."). The Ohio statute, while protecting the buyer who has put twenty percent equity into the home, is less protective of the buyer who has put in little equity but made payments for years. In those cases, Texas (with four years of payments required) is friendlier to the buyer. See TEX. PROP. CODE ANN. § 5.066 (West 2006). The Restatement notes that any hybrid system, whether 5%, 10%, or 40%, creates an arbitrary cut-off. See RESTATEMENT (THIRD) PROP.: MORT. § 3.4 cmt. c (2009).

does not pay on time. They may see the loss of the forfeiture right as a hassle and added cost and may be less likely to contract with low-income borrowers with shaky credit.<sup>89</sup> Contract for deed has proved to be a stable path for homeownership in border communities. One study found that three-fourths of all residents have lived on their lots for at least ten years.<sup>90</sup> The goal of this Article is not to decide between the Restatement or hybrid approach, especially if eliminating contract for deed means that low-income people lose their one option for home financing.<sup>91</sup> The point is that converting a contract for deed to a mortgage should be automatic, whether that conversion occurs at contract inception or after the buyer has paid a certain amount of the home's purchase price. For example, if a standard FHA mortgage only requires a downpayment of 3.5% to create a mortgage, it is hard to justify why a contract for deed buyer must put down 40% before enjoying similar rights.<sup>92</sup>

*B. Treat Lease-to-Own Contracts as Mortgages After Buyer Makes  
Downpayment in Excess of Monthly Payments*

Option contracts are common in the commercial real estate market, where a prospective buyer leases a property and pays extra for an option to change the purchase agreement at a later time during the lease.<sup>93</sup> The extra charge for the option ensures that the buyer has the exclusive right to purchase and is not competing with other parties. Option contracts make sense in the commercial context, where buyers and sellers are more likely to be on equal footing. The buyer pays extra for the opportunity to try out a property and purchases it if it meets the buyer's requirements.

In the residential context, option contracts, also called lease-to-own or rent-to-own agreements, are more problematic. In most cases, the buyer is expected to make a hefty downpayment so she has the exclusive "option" to purchase the home.<sup>94</sup> The contract specifies that the buyer must inform the seller that she wishes to exercise her option to purchase, which then converts the rental

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89. See, e.g., Freyfogle, *supra* note 16, at 306 (arguing that "treating an installment land contract as a mortgage is harsh because it largely destroys the installment contract as a unique financing alternative.").

90. See WARD, WAY & WOOD, *supra* note 17, at 6:7.

91. Some authors believe contracts for deed can be a good option, especially when nonprofit agencies and housing organizations use them to build credit and homeownership in low-income communities. See Roy, *supra* note 2.

92. Although mired in procedural complexity, hybrid systems like Texas do automatically grant rights similar to mortgages after 40% of the payments are made, or the buyer has made four years of payments. The problem is that the buyer is required to put down a comparatively large amount of money to achieve similar benefits to mortgage holders.

93. See generally John C. Murray, *Options and Related Rights with Respect to Real Estate: An Update*, 47 REAL PROP. TR. & EST. L.J. 63 (2012).

94. There is no set amount for the option to purchase. In contracts I have reviewed, the option is usually 10% of the total purchase price.



agreement into a seller-financed sale.<sup>95</sup> The idea behind a residential option contract is the same as a commercial contract: if the buyer makes monthly payments, he is protected from eviction and rent increases, and he has the option to buy if he wants.<sup>96</sup> The problem is that low-income people do not make large downpayments with the idea that they may or may not wish to keep the property. When Mr. Rivera made his downpayment of \$3000, he believed that he was purchasing the home. He did not understand the additional requirement to send a certified letter stating that he wanted to convert his lease-to-own into a purchase agreement; in his mind, he already owned the home and there was nothing further required to make it a sale.<sup>97</sup>

The 2005 legislation added option contracts to the definition of executory contracts, giving the buyer under an option contract some of the protections of a contract for deed.<sup>98</sup> Like the other legislative amendments, option contracts were added in an effort to protect the buyer from abusive practices.<sup>99</sup> Curiously, however, buyers under option contracts do not have many of the protections of buyers under contracts for deed. For example, even after the buyer exercises the purchase option she does not have the right to a foreclosure sale and return of equity if she defaults on the contract.<sup>100</sup> Also, buyers under option contracts cannot have liens for utility service, cannot pledge interest in property, and, for some reason, do not have the right to request a payment balance for the property.<sup>101</sup>

The problem Mr. Rivera encountered was that he did not know how to exercise his option to purchase, believing that a downpayment of \$3000 meant that he had bought the property. Indeed, given the general understanding that a renter pays only monthly rent, and a buyer pays a downpayment and monthly installments, it makes sense that Mr. Rivera was confused about his ownership status. This Article argues that, similar to making the conversion process automatic, exercise of the purchase option should be automatic as soon as the buyer makes a

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95. See WILLIAM V. DORSANEO, *REAL ESTATE SALES CONTRACTS* (2012); see also Way, *supra* note 11, at 132 ("the homebuyer pays a nonrefundable option fee up front, similar to a downpayment. The homebuyer then makes monthly payments under a lease for a set term.").

96. See *S. Vanguard Ins. Co. v. Silberstein*, No. 14-09-00472-CV, 2010 WL 2998786 at \*4 (Tex. App. Aug. 3, 2010) ("unlike a mortgage, a purchaser has the right to rescind the contract and walk away from the property with no further liability"); Mixon, *supra* note 22, at 611.

97. In Mr. Rivera's case, the seller also made verbal representations about the contract that were not reflected in writing and congratulated him repeatedly on "buying" the home. In this author's experience, unscrupulous sellers often make extra-contractual statements that misrepresent the terms of the contract, to encourage the buyers to complete the deal.

98. See TEX. PROP. CODE ANN. § 5.062(a)(2) (West 2006).

99. See SENATE RESEARCH CENTER, *BILL ANALYSIS*, Tex. H.B. 1823, 79th Leg., R.S., at 1 (2005), available at <http://www.legis.state.tx.us/tlodocs/79R/analysis/pdf/HB01823S.pdf#navpanes=0> ("Contract-For-Deed and Rent-to-Own arrangements are home buying methods that leave the buyer extremely vulnerable to serious abuses, and deny homebuyers many of the same basic benefits and rights that other homeowners have.").

100. See TEX. PROP. CODE ANN. § 5.062(e) (West 2006).

101. See *id.* § 5.062(e).

downpayment in excess of a the first monthly payment and security deposit. That way, an unsophisticated buyer will not be trapped by failure to understand the intricate option-exercise provisions, and the buyer's substantial investment in the home will be protected like any seller-financed transaction. In a dispute over whether a buyer has exercised his option to purchase, the buyer's intent to purchase should control. Any contractual requirement that requires a buyer do something to finalize the purchase, other than make a downpayment, should be construed against the seller, using standard common law contract principles.<sup>102</sup> Importantly, an automatic option equalizes the rights and remedies of the buyer/homeowner regardless of whether he financed the home using a mortgage, a contract for deed, or a lease-to-own contract.

*C. In Addition to Making Conversions Automatic, Easy Fixes Exist to Improve Current Law on Disclosure, Clarity of Credit Terms, and Penalties for Not Recording Deeds*

Executory contracts for the conveyance of land continue to be confusing and difficult for Texas buyers to understand, notwithstanding the consumer-friendly changes to the law. Sellers are required to disclose the property conditions, tax payments, and finance terms, but there are no specifics on font size, where these terms appear in the document, or the penalties to the seller if she fails to comply with the disclosures.<sup>103</sup> Although standard real estate contracts and procedures are often criticized for being favorable to the seller,<sup>104</sup> a standard contract for deed form is one way to ensure that all required terms are clearly written and included in the contract.<sup>105</sup> Minnesota already includes a standard form contract for deed in its property code.<sup>106</sup> And at least as far as the current conversion process, Texas law encourages the use of forms published by the Texas Real Estate Commission.<sup>107</sup>

Sellers are already required to make many disclosures under the contract for deed law, and there are harsh penalties for noncompliance. For example, sellers

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102. See RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981).

103. See TEX. PROP. CODE ANN. §§ 5.069-5.071 (West 2006).

104. See, e.g., Patrick K. Hetrick, *Drafting Common Interest Community Documents: Minimalism in an Era of Micromanagement*, 30 CAMPBELL L. REV. 409, 428 (2008) (“[i]n too many instances, the consumer has been placed in an inferior legal position by a combination of little or no bargaining power, real estate broker disclosure forms, seller disclosure forms, lengthy standard-form real estate sales contracts and addenda, 30-page-long mortgage forms, warranty and inspection forms, and tome-length common interest community governance documents.”).

105. Standard forms are one of many recommendations of the “Contract for Deed Prevalence Project,” which notes that Texas statutes provide standard language in many areas, such as the Affidavit of Heirship in Chapter 52A of the Property Code. See WARD, WAY & WOOD, *supra* note 17, at XII.

106. See MINN. STAT. ANN. § 507.09 (West 2002) (noting that the Minnesota Uniform Conveyancing Blanks Commission has filed several model instruments with the secretary of state, which are approved for use in the state); see also *Uniform Conveyancing Blanks*, MINN. DEP’T OF COMMERCE, <http://mn.gov/commerce/images/UniformConvBlanksList.pdf> (last visited Mar. 24, 2013).

107. See TEX. PROP. CODE ANN. § 5.081(g) (West 2006).

must provide an annual accounting to buyers with specified information on payments made and total amount remaining on the contract or risk penalties of \$250 per day plus attorney's fees.<sup>108</sup> But other required disclosures, such as financing terms, have no penalties at all when the seller fails to include them in the contract.<sup>109</sup> More meaningful disclosures would be similar to disclosures required under the federal Truth in Lending Act for mortgages.<sup>110</sup> These disclosures include the total amount financed, the annual percentage rate, total payments, payment schedule, total sale price, and late payment fees. Failure to use a standard form with these terms would subject a seller to an action under the deceptive trade practices statute.

Another critical protection for buyers is the requirement to record a contract for deed, but this requirement also lacks any enforcement teeth.<sup>111</sup> Sellers are required to record contracts for deed within 30 days of contract execution, but there is no penalty for failing to do so.<sup>112</sup> Recording a contract is a critical protection from the seller. When contracts are not recorded, sellers can try to re-sell the property to a bona fide purchaser, who may claim he had no notice of a prior claim to the property.<sup>113</sup> If penalties existed for failing to record a contract for deed, Ms. Alvarado would have a strong claim for statutory damages against the sellers who failed to record her contract for deed and sold the property to a third party.

## V. CONCLUSION

*"There is a wide distinction between homes and mere housing. Those immortal ballads, Home, Sweet Home; My Old Kentucky Home; and the Little Gray Home in the West, were not written about tenements or apartments . . . they never sing songs about a pile of rent receipts."*<sup>114</sup>

108. *Id.* § 5.077. These harsh penalties caused at least one author to suggest doing away with contract for deed. See Mike Lee, *Contract for Deed: Extinction Long Overdue*, 37 TEX. TECH L. REV. 1231, 1243 (2005). The Supreme Court of Texas, hesitant to assess statutory damages without a showing of fault, allows buyers to avoid paying damages when they can show that they were acting in good faith. See *Flores v. Millennium Interests, Ltd.*, 185 S.W.3d 427 (Tex. 2005).

109. See TEX. PROP. CODE ANN. § 5.077 (West 2006) (specifying penalties for failure to provide annual accounting but not for failure to disclose financing terms).

110. For the most part, sellers under contract for deed are not bound by the Truth in Lending Act (TILA) because they are not "creditors" who regularly extend or arrange for the extension of consumer credit. See 12 C.F.R. § 226.2 n.3 (2011) (credit is extended regularly if it is extended 25 times or more in the preceding or current calendar year).

111. See TEX. PROP. CODE ANN. § 5.076 (West 2006).

112. *Id.*

113. See NAT'L CONSUMER LAW CTR., *supra* note 29, at 429 ("lack of recordation may leave the buyer unprotected against a subsequent purchaser of the property who acquires an interest without notice of the installment contract").

114. President Herbert Hoover, 31st President of the United States, Address to the White House Conference on Home Building and Home Ownership (Dec. 2, 1931), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=22927>.



Homeownership is a life goal for many Americans, but for low-income homebuyers during the credit crisis, getting a bank mortgage is out of the question. Buyers like Ms. Alvarado, Mr. Rivera, and Mr. Guerrero do not have the income or credit to qualify for traditional mortgages. Seller financing is the only way for low-income people like them to buy homes, and in Texas, buyers purchase homes through contract for deed and lease-to-own agreements. These agreements suffer much criticism because they often combine the interest rate of a sub-prime loan and the abusive practices of the worst predatory lenders. But as long as low-income homebuyers lack financing alternatives, contract for deed and lease-to-own agreements will endure.

Texas contract for deed legislation was enacted to prevent abuses and punish unfair practices. It provides many important protections for buyers, but also puts the burden on them to assert important rights. A better system would make the contract for deed and lease-to-own agreement as similar to a mortgage as possible, without requiring the buyer to take affirmative steps. Conversion should be automatic for both contracts for deed and lease-to-own contracts, disclosures should parallel Truth-in-Lending requirements, and penalties should be instituted for failure to record contracts for deed. Other easy fixes can help low-income buyers, such as statutory standard forms, required credit disclosures, and sensible penalties for not providing required disclosures to the buyer.

The consumer protection goal in seller-financed transactions is to level the playing field during the negotiation process *and* to level the rights and benefits between traditional mortgages and residential installment contracts. When two people, one with a mortgage and one with a contract for deed, put the same financial and emotional equity into making their house a home, their rights and remedies should not depend on the type of financing they were able to secure.